Audit's® MARKET ANALYSIS OF SECURITIES OF REITS AND REAL ESTATE COMPANIES

Realty Stock Review

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MARKET STRATEGY: JUST WHEN THE BEARS SEEMED IN CHARGE, THE BULLS RETURNED

When last we wrote you, the Dow-Jones Industrials had just dropped like a stone after mounting a third effort to top the 1900 mark decisively. Now the DJI has turned decisively upward to new highs, which was attributed to sophisticated arbitrage but probably indicates investor opinion that the economy will strengthen in 1987 and both the Iranian arms sale brouhaha and the Boesky insider trading fears will slowly fade.

The table on page 6 shows both the DJI and S&P 500 up nearly 5% in the last two weeks, while realty stocks clearly lagged with only a 0.2% gain overall. Only the manufactured housing group matched the broad averages (up 4.8%) while realty services and syndicators continued weak with a 4.1% fall. Equity REITs were weak while mortgage trusts did better.

In looking at these numbers, it's wise to remember that these percentage changes are not adjusted for dividends. Since most REITs pay about twice the dividends of the averages, their stock prices always look weak even though investors get a higher overall return.

The year 1986 is winding down with real estate clearly out of investor favor. Many property owners are trying to sell before year-end to take advantage of the lower capital gains rates. So far Japanese and other foreign buyers seem more willing to step up for major properties than U.S. investors.

U.S. investors, with a typical shorter-term focus, look at the latest inflation rate numbers (low and still falling) and figure they'll buy real estate when inflation starts to heat up again as an inflation hedge. Foreign investors take a longer view and see the stable U.S. economy as a good haven for investment dollars.

What's happening with big U.S. property buyers? Two of the biggest cash stashes by REITs are held by **New Plan Realty** and **Pennsylvania REIT**, who have nearly $140 mil. to invest. They are reviewed on pages 4 and 5. An aggressive buyer of properties and companies, **Southmark Corp.**, is reviewed on pages 5 and 6.

The REIT format is turning hotter as we turn into the new year, and two companies are preparing to convert to REIT status with the flip of the calendar. One, **Cousins Properties**, is a major land holder validated by some blue chip financial backing. The other is **American Realty Trust**, once a REIT and now requalifying after a merger.

Stock charts courtesy Mansfield Stock Chart Service

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COUSINS PROPERTIES AND AMERICAN REALTY TRUST TO QUALIFY AS REITS FOR 1987

Two operating companies will elect to qualify as REITs for 1987. One, **American Realty Trust**, will be requalifying, since it operated as a REIT for 13 years before disqualifying itself in 1974. The other is Atlanta developer and income property builder, **Cousins Properties, Inc.**, which sponsored and managed a separate REIT in the 1970s but has never been a REIT itself.

The qualifications signal the belief that REITs were strengthened by the 1986 Tax Reform Act and are emerging as a public vehicle of choice in the increasing securitization of real estate.

Cousins Properties Inc. (20--OTC) has all but firmly decided to qualify as a REIT beginning the new year; directors in Oct. approved studying the question and COUS says that study has turned up no barriers to qualification to date. COUS is the major public vehicle of Thomas G. Cousins, veteran Atlanta developer and 26% owner. We are raising COUS to A Rank.

COUS is a play on benefits from a major joint venture with IBM to develop a premier office park in northwest Atlanta. COUS will contribute the land and development/leasing skills while IBM puts up money. The venture plans to hold for long-term investment the land and improvements, which we estimate could amount to about 9.0 mil. net sq. ft. of office and commercial space.

EPS/Dividends - B: COUS earnings are historically volatile because of large but unpredictable land and property sales. Quarterly and annual EPS are less important than value growth in underlying assets. COUS earned 82¢ in 1985, down from $2.68 of 1984 that benefitted from sale of five shopping centers. EPS rose 234% to $1.07/sh. in the six months thru June, with land sales to set up the IBM joint venture a major contributor (see IBM Venture below). COUS split its stock 3-for-2 in May and boosted payout 20% to 32¢ in August.

Assets and Operations: As a major land owner, COUS derives the biggest profits from selling major land parcels, and on occasion income properties it has developed. Much property activity takes place in joint ventures and its two largest partners are IBM and Coca-Cola, strictly blue chip. It also owns income properties and receives development, management and leasing fees from these properties and joint ventures.

IBM Joint Venture: In 1985 COUS formed Wildwood Associates, 50/50 joint venture with IBM to develop 238 acres in Wildwood Office Park, 275-acre office and commercial development in northwest Atlanta. The venture will develop and own all future Wildwood improvements except two completed offices with 296,000 SF now fully leased to IBM. IBM would contribute a total $117 mil. over several years. The first phase of the venture involved COUS's sale to IBM for $15.9 mil. (or 5% over COUS' cost) of 100% of a partially completed 300,000 SF office building and 50% of a completed restaurant on three acres in Wildwood. IBM then contributed these properties plus $15.6 mil. cash for a 50% interest in the first phase of Wildwood Associates; COUS contributed 9.5 acres and its half of the restaurant for its 50% share. COUS is committed to contribute an additional tract with $1.85 mil. cost at an agreed upon $24.8 mil. value for the second phase of the venture, and will contribute additional land upon IBM's contribution of additional cash.

The accounting result was that COUS reported only nominal gross profit ($753,000 or the 5%) on its $15.9 mil. land sales in 1985. However, it received $16.9 mil. cash from Wildwood Assoc. during the June qtr. and booked the previous contribution as a sale for $14 mil. gross profit. COUS books its remaining Wildwood land at less than $1/SF, vs. about $13/SF value as contribution to the venture. The IBM commitment to Wildwood now includes leasing 60% of the third 300,000 SF office in addition to leasing the first two buildings. The Venture has begun building an 11-story, 650,000 SF office.

COUS and IBM have also formed a second 50/50 joint venture, Green Valley Associates, to ground lease and develop 380,000 SF office space on 21 leased acres in Greensboro, N.C. IBM leased 60% of the first 140,000 SF building,

now being finished.

Coca-Cola Joint Venture: Late in 1985 COUS contributed 40 undeveloped acres on Ga. Hwy. 400 (major new expressway running north from Atlanta) to a venture with a Coca-Cola subsidiary, which contributed 11 acres in downtown Atlanta containing a bottling plant. Development plans for the 40 acres are not finalized yet. This is near a larger 617 acre site in an expanding area owned by COUS, and where COUS has agreed with Homart Development (Sears) and JMB/Federated to coordinate developing a 100-acre regional shopping mall.

Financial Measures - A: Parent company debt has been pared to $22.0 mil. at June 30, using land sale proceeds, or 0.4 times equity of $56.4 mil. or $4.93/sh. Joint ventures held $175 mil. assets at Dec. 1985 and are leveraged about 1-to-1. COUS capitalization includes $44.1 mil. deferred income taxes ($3.86/sh.). Accumulated depreciation on wholly owned properties is minor (16¢ sh.) and COUS is not a classic cash flow company.

Exposure - B: With substantial assets centered in Atlanta, COUS' transactional income depends heavily upon that local economy. Asset values are sound and Wildwood, which was acquired starting in 1971, has substantial appreciation. We estimate Wildwood accounts for about $7/sh. unrealized appreciation and the Rt. 400 tract, carried at less than $14,000/ac., may add another $4/sh. or so gain. The total plus book value and deferred taxes equals today's price. While not cheap, COUS essentially gives investors all the appreciation on its sizeable other land and property holdings for free.

American Realty Trust (9-3/8--ASE) acquired Novus Property Co. (formerly First Wisconsin Mtg. Trust) in Oct. and now will requalify the combined company as a REIT for 1987. The new ARB has 9.68 mil. shs. outstanding with pro forma $10.19/sh. book value (total $98.7 mil.). Southmark Corp. owns 83.3% of ARB following the merger and said it would divest its holdings below 50% via sale or other distribution. To prepare for the change, ARB agreed to buy $29 mil. mortgages from Southmark discounted to yield 11%, and then make a $2.50/sh. distribution to holders of record Dec. 15. We are holding ARB's C Ranking.

EPS/Dividends - C: The two trusts earned $1.21/sh. pro forma combined in their 1985 fiscal years, and earned 47¢ pro forma in the nine months to June 1986. ARB will continue with a Sept. fiscal year. Dividend policy beyond the $2.50 special payout isn't clear now.

Assets and Operations: Pro forma combined assets of $110.7 mil. at June 30 are divided $20 mil. (or 18%) net real estate; $31.9 mil. (or 29%) mortgages, net; $51.7 mil. (47%) notes receivable from Southmark; and the rest cash and other assets. Pro forma combined revenues of $17.7 mil. for the nine mon. to June were 31% property sales; 27% rentals; 42% interest and other income. Property sales generated 18¢ gross profits and rentals 12¢ before depreciation and overhead.

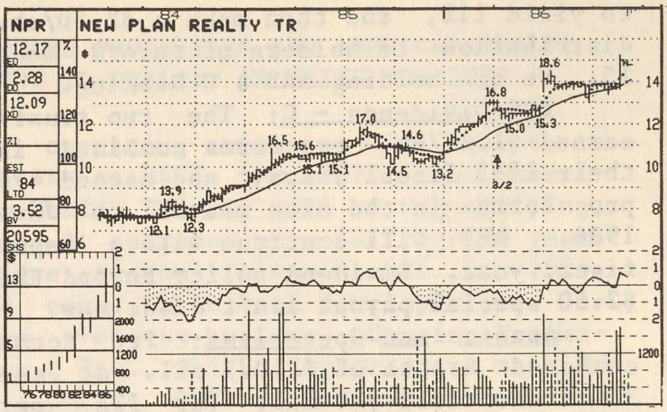
Major properties and appraised values before debt are: Las Vegas Plaza shopping center, $18.2 mil.; McGuires Inn in Arden Hill, Minn., $6.5 mil.; Fountain Woods condos, Edina, Minn., $3.05 mil.; six acre parcel in downtown Atlanta, $12.2 mil. (or $50/SF); Mopac Bldg. in St. Louis, $2.8 mil. Novus assets are marked to market in the merger but ARB's old assets stay at historic cost. The Atlanta land appraisal is $4.9 mil. over ARB's old retained book value, or 50¢ over book. ARB notes however that it recently sold a one-third acre piece of this tract for $135/SF, or $2.15/sh. appreciation if that value held for the entire parcel.

Financial Measures - C: ARB starts its new life with only $5 mil. debt or 0.05 times $98.7 mil. shareholders equity. Liquidity is adequate.

Exposure - C: ARB will continue to focus on disposing of old REIT assets while building a portfolio of mortgages initially. Southmark management will remain in control (see page 5).

RANKING REVIEWS: NEW PLAN REALTY AND PENNSYLVANIA REIT RETAIN A RANKINGS

New Plan Realty Trust (14-1/2--NYSE) holds A Rank. NPR specializes in buying older shopping centers in the Northeast and upgrading rents and returns via



aggressive expansion, renovation, re-leasing and promotion. As result, rental returns are one of the highest percentages of invested assets in the REIT group.

<u>EPS/Dividends - A</u>: Net operating cash flow per share, which we regard as NPR's best performance measure, rose 5.5% to 77¢ sh. in the July 1986 fiscal year; operating CFS has risen at 13.2% over the past five years. NPR added 3.5¢ property sales gain in 1986. NPR has boosted dividends over that span at a 17.0% annual rate and paid $0.73 in 1985 and now pays 80¢ annually. Payout was about 95% of operating cash flow and 90% of total CFS. NPR expects about 10% dividend growth in 1987.

<u>Assets and Operations</u>: Total assets of $190.7 mil. are 36% net property; 1% notes receivable; 57% cash and marketable securities; 6% other. NPR's $109 mil. cash and marketable securities holdings are largest among REITs and give NPR tremendous leverage in bidding for property purchases. But since interest yields are lower than real estate yields, the cash hoard probably penalized 1986 results by 10-12¢.

<u>Properties</u>: NPR's $82 mil. gross property investment before depreciation are divided 85% in ownership of 33 shopping centers with 4.11 mil. SF; 12% in five apartment projects with 838 DU; and 3% commercial. NPR bought 13 shopping centers with 1.26 mil. SF in 1986, paying $22.97 mil. or $18.23/SF. All are anchored by Nichols department stores which occupies 88% of space. They are in N.C., Va., Pa., Md. and N.Y. NPR specializes in buying older centers to renovate them and boost rents: its centers have average cost of $17.97/SF and average rents are $4.82/SF or 26% on cost, but down from last year because the Nichols centers are below average. In contrast new Sunbelt strip centers often cost $40-$60/SF and rents run 10%-12% of cost. NPR's lower cost helps it manage the risk of running many smaller strip centers (32 centers are wholly owned, including one enclosed mall) in smaller cities in N. Y. and Pa. Shopping centers account for 80% of NPR's $21.9 mil. rents (and 60% of $32.3 mil. revenues). Roosevelt Mall in Philadelphia with 597,00 SF accounts for 26% of rents. Centers command the lion's share of management's estimated net asset value. Centers are 97% leased, up 1% in the year. NPR's five apartments are about 85% occupied.

About 30% of NPR's 1986 income came from interest and dividends on NPR's $109 mil. cash and marketable securities. Included are 352,000 shs. (or 5.4%) of Pennsylvania REIT (see below) and $7.1 mil. of First Union Real Estate convertibles.

NPR continues to seek acquisitions and is expected to make some purchases by 1986 year end, to accommodate sellers who want to take capital gains at 1986's lower rate.

<u>Financial Measures - A</u>: With $109 mil. cash, NPR is very liquid. Debt of $96.3 mil. is 1.05 times $90.9 mil. equity at historic cost. Debt includes $28.4 mil. mortgages on properties and $66.7 mil. debentures convertible at $11.49, or into 5.81 mil. shs. Major shareholders are Merchant Navy Pension Fund of England, 22.8%; and the founding Newman family, 14.7%.

<u>Current Value</u>: Management estimates current value of net assets at $303.1 mil. vs. $90.9 mil. cost. Audit computes fully converted net asset value to be $14.01/sh.

<u>Exposure - A</u>: NPR's strategy of staying liquid and being an opportunistic buyer of less glamorous (but highly profitable) frostbelt shopping centers has insulated it from ruinous competition from major institutional and foreign property owners. With Nichols department stores now occupying about 27% of center space, risk to this single tenant is increased slightly. Reinvestment of cash should aid EPS/CFS.

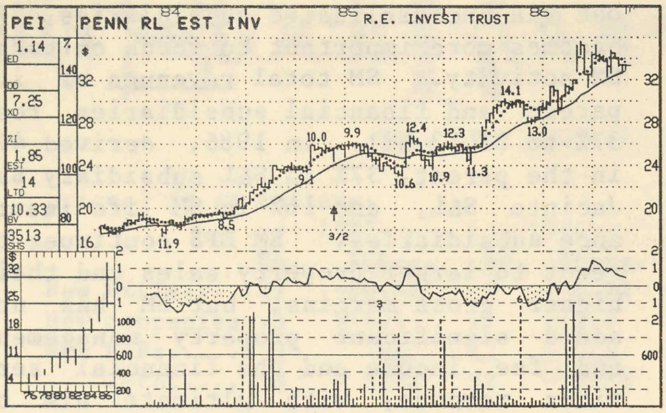
Pennsylvania REIT also holds A Rank by maintaining EPS and dividend gains. EPS/Dividends - A: PEI generated $2.13 sh. net operating cash flow before property sale gains in its Aug. 1986 fiscal year, down 9%; the decline lowered PEI's annual growth in operating CFS the past five years to 6.9%. The decline was attributed to higher insurance costs and a 35% increase in shares outstanding from conversions. Property sale gains added 31¢ in 1986, up from 19¢. Dividends have risen at 20.3% over that span and are at $2.10 annually.

PEI owns interests in 45 properties, of which 16 are directly owned and 29 held by joint ventures in which PEI generally holds 50% (but ownership ranges from 25% to 75%). Asset mix thus isn't always clear to casual observers but total holdings of $121.4 mil. properties at cost are 41% ($49.4 mil.) in wholly owned properties and 59% ($72.0 mil.) assets at cost in joint ventures.

Property mix is heavily weighted to shopping centers at 55% of combined cost; 29% in 9 apartments with 2,372 net DU; 7% office/industrial; 9% in land and construction in process. Most PEI activity in recent years focuses on developing new shopping centers via joint ventures and PEI owns interests in 20 shopping centers with about 2.45 mil. net SF. The centers generate about 50% of net cash flow with apartments the other strong contributor. Centers are 94% occupied overall at Aug. In 1986 PEI bought 50% of 85%-leased 173,000 SF Valley Forge Mall in Phoenixville, Pa., and is refurbishing mall space; entered joint ventures to build two new centers totaling 346,000 SF in Jacksonville, Fla.; and a venture to build a 277,000 SF center in Deptford, N.J.

Gross revenues from combined real estate rose 8.0% to $25.7 mil. in 1986, divided 55% in joint ventures and 45% wholly owned properties. Direct operating expenses rose 14.6%, due almost solely to higher insurance premiums, and net operating income rose only 3.9%.

Financial Measures - A: Debt on the balance sheet totals $13.6 mil. and is 93% fixed mortgages on properties and 7% debentures convertible at $17 (thru July 1988) or 59,000 additional shs. Total debt is 0.2 times $59.8 mil. equity at cost, or $11.02/sh. to which we add $4.10/sh. depreciation on directly owned properties. Joint venture properties are subject to $48.1 mil. mortgages and other debt; accumulated depreciation equals $2.98/sh. Liquidity is excellent with $30 mil. cash and equivalents (or $5.52/sh.).



Exposure - A: PEI's strategy of building a portfolio via joint ventures, and of staying close to its Pennsylvania base, has provided steady cash flow growth. This has attracted outside shareholdings from New Plan Realty (5.4%); and First Pacific Advisors, a mutual fund managed by a unit of Angeles Corp. (5.7%). Chrm. Sylvan Cohen owns 8.1% and all trustees own 18.2%. EastGroup Properties, another REIT, sold a block after its request for board representation was refused.

RANKING REVIEWS: SOUTHMARK CORP. HITS BUMPS ON ROAD TO REALTY CONGLOMERATEHOOD

Southmark Corp. (8-3/4--NYSE) holds C Rank in our annual review. It's been a wild ride since 1985: SM rose from 8-3/8 a year ago to touch 14, then fell all the way back as concerns over impact of tax reform, and a regulatory slap at its Houston-based S&L subsidiary hurt.

EPS/Dividends - B: SM earned $1.54 primary ($1.39 diluted) in its June 1986 fiscal year, down 7% fully diluted. SM earned 9¢ sh. diluted in the Sept. qtr., down 77% from a 1985 quarter that included 37¢ from a single property sale. Since converting from a mortgage REIT, SM has been able to increase reported EPS and resume dividends, which held at 24¢ annual rate in 1986.

As more SM activities are carried

out via unconsolidated subsidiaries, it becomes more important to focus on total SM activity. SM total revenues of its parent and financial subsidiaries rose 37% to $1.13 bil. in 1986, derived 47% in the parent, 37% in S&L subsidiary San Jacinto S&L, and 16% in SM life insurance subsidiaries. SM EPS continues to react to larger property sales and their higher gross margins, but SM has now added significant property management and fee income and the financial services revenue, with ultimate aim of producing more recurring income streams. Property sales both by SM directly and thru San Jacinto totaled $619 mil. in 1986, with 63% coming thru San Jacinto. Total property sales were 38% syndications, 16% recreational land, 24% other land, and 22% housing, condominiums, and other property. SM derives total revenues before eliminations 30% from direct sales of property and land to third parties; 15% property management; 24% syndications; 13% recreational land; 7% mortgage servicing; and 10% oil and gas, direct mail, and brokerage. Operating margins were 30.3%.

Assets and Operations: Property management and services are increasing. Via several acquisitions SM now manages 80,000 apartments, 115 shopping centers with 15 mil. SF; 100 offices and warehouses with 10 mil. SF, and 100 hotels with 25,000 rooms. Property management grew with acquisition of Robert A. McNeil Corp. in 1986, adding management of 47,000 apartments; and a 49% interest in Servico responsible for managing 12,000 rooms. In Sept. SM acquired Realty World Corp., third largest North American realty brokerage franchiser. SM also owns 37% of Pratt Hotel Corp., a hotel operator making an effort to acquire Resorts International, a casino operator.

In financial services, SM acquired insurance holding company Integon in Dec. 1985, adding 1,500 field agents to handle SM products. Southmark Financial Services, a securities broker-dealer, expanded its registered rep network to 1100, and SM is forming a joint venture with Sass Investments to package mutual funds for sale thru this network. SM acquired Consolidated Resources Corp. and became fourth largest health care provider. A concern is $3.5 bil. asset San Jacinto Savings Assn., Houston, where Federal regulators, increasingly concerned about oil patch thrifts, in Sept. required SM to sign an interim operating agreement restricting San Jacinto's commercial real estate lending, syndications; barring dividend payments to parent SM; and requiring a 43% reduction in real estate assets by June 1987. As result, SM may sell San Jacinto.

Financial Measures - C: Total debt of $1.52 bil. is 2.0 times net equity, plus $214 mil. liquidating value of preferred over carrying value, for obligations of $1.7 bil. or 2.6 times net equity. Equity of $665 mil. equals $9.64/sh. SM sold $100 mil. of Series H preferred in Oct. and called $76 mil. of Ser. F preferred.

Exposure - B: SM has financed acquisitions with a combination of debt and securities based upon expected profit performance of acquirees and/or resale of properties at higher prices. Real estate markets have favored this strategy for the past five years, but lower inflation ahead may require some corrections to strategy.

COMPARATIVE REALTY STOCK GROUP AVERAGE 12/03/86

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-% CHANGE 11/20/86	FROM JAN	P/E 1RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKE[illegible] VAL(0[illegible]
1 PROPERTY REITS	44	4	48	6246	10.79	1.20	1.14	15.97	-0.6	10.4	14.0	7.5	48.1	10.6	5155.[illegible]
2 PROP & MTG COMB REITS	21	3	24	5789	12.88	1.38	1.10	14.61	-0.2	0.3	13.3	9.5	13.5	8.5	2112.[illegible]
3 MORTGAGE REITS	16	1	17	5157	14.41	1.58	1.67	16.46	1.0	11.9	9.8	9.6	14.2	11.6	1601.[illegible]
4 PARTICIPATING MTG REITS	12	0	12	8220	12.64	1.18	1.25	12.93	0.8	-3.3	10.4	9.1	2.3	9.9	1410.[illegible]
5 MAJOR HOMEBUILDERS	8	4	12	16906	10.63	0.48	1.50	19.26	0.7	33.8	12.8	2.5	81.2	14.1	3187.[illegible]
6 OTHER BLDRS/DEVELOPERS	9	27	36	6040	5.70	0.13	0.30	8.41	0.1	2.2	28.5	1.5	47.7	5.2	1901.[illegible]
7 INCOME PROP BLDR/OWNR	17	10	27	6028	11.38	0.70	1.05	18.03	0.9	8.5	17.2	3.9	58.4	9.2	3349.[illegible]
8 MORTGAGE BANKER/FINANCE	12	5	17	13159	10.84	0.78	1.26	15.55	1.6	5.5	12.3	5.0	43.4	11.6	5154.[illegible]
9 DIVERSFIED RLTY&HOLDING	13	8	21	22563	13.29	0.30	0.96	18.04	-1.0	14.1	18.8	1.6	35.7	7.2	1[illegible]
10 RLTY SVCS/SYNDICATORS	2	4	6	8186	6.61	0.04	-0.31	8.19	-4.1	-21.4	0.0	0.5	23.9	-4.7	[illegible]
11 MANUFACTURED HOUSING	4	6	10	12389	6.08	0.14	0.21	8.90	4.8	-11.4	43.2	1.6	46.5	3.4	[illegible]
L LIQUIDATING COMPANIES	1	0	1	5954	2.22	0.19	-1.02	3.63	-14.7	-44.2	NC	NC	63.3	NC	21.[illegible]
P PREFERRED STOCKS	2	0	2	1923	11.25	0.93	0.00	13.75	1.4	5.3	NC	NC	22.2	NC	53.[illegible]
OVERALL AVERAGE			233	9038	10.55	0.79	0.97	14.58	0.2	7.6	15.0	5.4	38.2	7.5	39787.[illegible]
DOW JONES INDUSTRIALS							90.78	1947.27	4.7	25.9	21.5	3.5			
STANDARD & POOR'S 500							14.76	253.85	4.9	20.1	17.2	3.5			
DOW JONES UTILITIES							17.60	213.84	3.2	22.3	12.2	7.4			